STATE OF NEW HAMPSHIRE DEPARTMENT OF STATE BUREAU OF SECURITIES REGULATION

| IN THE MATTER OF: | ; |
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Local Government Center, Inc., et al.

Case No: C-2011000036

RESPONDENT JOHN ANDREWS' MOTION TO DISMISS COUNT 2

Respondent John Andrews, by and through his counsel, Orr & Reno, P.A., moves to dismiss Count 2 of the Staff Petition as follows:

Introduction

Mr. Andrews is the former Executive Director of the Local Government Center, Inc. ("LGC"). The Bureau of Securities Regulation ("Bureau") claims to have charged not only the LGC, but also Mr. Andrews and others with financial mismanagement of the LGC and its related entities in Count 2 of the Staff Petition. By asserting these charges, the Bureau, instead of enforcing the law, has effectively promulgated an *ad hoc* set of standards and rules concerning required reserves, limits on the nature and extent of administrative expenditures, and restrictions on the LGC's Board of Directors' ("Board") discretion to determine the "projected needs of the plan" that were not enacted or even contemplated by the legislature, thereby unconstitutionally overstepping the Bureau's regulatory authority. As a consequence, these standards are without effect, and their imposition on Mr. Andrews and others to subject them to civil or administrative liability is unconstitutional. For these reasons, Count 2 should be dismissed.

¹ On December 3, 2011, Mr. Andrews moved to dismiss Count 2 against him for failure to state a cause of action. The motion remains pending. While Mr. Andrews contests that Count 2 states a cause of action against him, the instant pleading recognizes that the Bureau claims to have charged Mr. Andrews in Count 2.

Argument

I. Mr. Andrews and all Respondents acted in full compliance with the statutory requirements of RSA 5-B:5.

The allegations in Count 2 of the Staff Petition may be summarized as follows:

- a) The LGC failed to return "all earnings and surplus in excess of any amounts required for administration, claims, reserves and purchase of excess insurance" to the participating political subdivisions, as required of risk management pools by RSA 5-B:5, I(c).
- b) The LGC erroneously interpreted RSA 5-B:5, I regarding the costs reasonably required for "administration" and the "projected needs of the plan." *See* RSA 5-B:5, I(f), (c).
- c) The LGC improperly spent or invested monies that should have been returned to the political subdivisions pursuant to RSA 5-B:5, I(c).
- d) The LGC improperly required participating political subdivisions to join associated non-profit municipal associations.

Staff Petition, Count 2, §§ A-D. The fundamental flaw with Count 2 is that RSA 5-B does not prohibit the various discretionary actions of the Board that the Bureau claims violate the statute. In fact, RSA 5-B does not establish or adopt the standards that the Bureau alleges have been violated.

Under RSA 5-B, the only specific financial management standards with which a pooled risk management program such as those run by the LGC are required to conform are the following:

- (c) Return all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions.
- (d) Provide for an annual audit of financial transactions by an independent certified public accountant. The audit shall be filed with the department and distributed to participants of each pooled risk management program.
- (f) Provide for an annual actuarial evaluation of the pooled risk management program. The evaluation shall assess the adequacy of

contributions required to fund any such program and the reserves necessary to be maintained to meet expenses of all incurred and incurred but not reported claims and other projected needs of the plan. The annual actuarial evaluation shall be performed by a member of the American Academy of Actuaries qualified in the coverage area being evaluated, shall be filed with the department, and shall be distributed to participants of each pooled risk management program.

RSA 5-B:5, I.

There is no dispute that the LGC obtained annual actuarial evaluations of its pooled risk management programs and provided for independent audits of its financial transactions by an independent public accountant. *E.g.* Staff Petition at ¶24. There is no dispute that the LGC, after annually obtaining a duly accredited, statutorily mandated actuarial evaluation, made a discretionary determination about the amount of capital the LGC needed to preserve to handle the costs of "administration, claims, reserves, and purchase of excess insurance." RSA 5-B:5, I (c); *see* Staff Petition at ¶¶24-28. There also is no dispute that the LGC used surplus funds available after these costs were assured to stabilize insurance rates for the participating municipalities. *Id.* at ¶40. The heart of the Bureau's charges of financial mismanagement is the Bureau's disagreement with these permissible, discretionary determinations.

In RSA 5-B:5, the legislature chose not to impose a requisite amount of reserves, a fixed sum or standard for determining acceptable administrative, claims-related, or excess insurance costs, or a specific form of return to be received by the participating municipalities. Nor has the legislature overlooked the issue. At the urging of the Secretary of State, the legislature held extensive hearings on this issue in the 2010 legislative session, and after hearing arguments for and against an amendment that would set legislative standards for an appropriate amount of reserves, administrative costs, and

the like, the General Court made no such alterations or amendments to RSA 5-B. Exhibit A, pp. 37-39 (2010 N.H. Laws 149:3, 4 (enacting amendments to RSA 5-B:5 without change to the specific amount of reserves required to be kept or limitations or restrictions on administrative costs)); see Exhibit B, pp. 2, 10-11 (Hearing Transcript, May 4, 2010, Senate Committee on Commerce, Labor and Consumer Protection (concerning House Bill 1393, relative to the treatment of New Hampshire investment trusts, and relative to pooled risk management programs at 9, 17-18)); Exhibit C, pp. 2, 5-9, 23-29 (Hearing Transcript, May 6, 2010, Senate Committee on Commerce, Labor and Consumer Protection (concerning House Bill 1393, relative to the treatment of New Hampshire investment trusts, and relative to pooled risk management programs at, e.g., 2, 5-6, 7-9, 23-29)). In fact, during the Senate hearings, the Bureau acknowledged that RSA 5-B does not establish an amount or a formula for setting an amount for a risk pool's reserves. Exhibit C, p. 2 (Testimony of Attorney Kevin Moquin: "[W]e do support the concept of providing a specific benchmark for reserves. It doesn't seem unreasonable to us that the Legislature should set a reserve level for the program the Legislature authorized, and it would give us further guidance as to what the Legislature considers a proper level of reserves.")

The same principle applies to the LGC's determination that surplus sums should be used to stabilize rate increases for the participating municipalities in the pooled risk management program. It is beyond dispute that RSA 5-B:5 imposes no specific form for the return of surplus assets to participating municipalities. *See* RSA 5-B:5, I(c). In fact,

² 2010 N.H. Laws 149:6 required the Secretary of State, in consultation with the insurance commissioner and through the use of an actuary with experience in pooled risk management programs, to provide the legislature with a report containing specific recommendations about the limitation or reserves and administrative expenses in a pooled risk management program. This underscores the fact that no such standards are expressed or implied by RSA 5-B:5.

Senate Bill 212-FN, which was introduced in the current legislative session, recognizes the lack of specific legislative mandate and proposes one for the return of surplus sums. Exhibit D, p. 4 (proposed amendment to RSA 5-B:5, I(c) that would require the "[r]eturn [of] all earnings and surplus in excess of any amounts required for claims, reserves and the purchase of excess insurance, and the reasonable costs of administration to the state or the participating political subdivisions which contributed to the pooled risk management program, annually and in cash").

Accordingly, pursuant to RSA 5-B, the LGC has the discretion to manage its pooled risk programs on behalf of its participating municipalities within the boundaries set by the legislature. See Berry v. School Board of Barrington, 78 N.H. 30, 32 (1915) (school board has discretion to deny transportation funding to student outside statutory transportation radius from school); cf. Dennis v. Jordan, 229 P.2d 692, 701 (Ariz. 1951) ("[I]t is the experience of the Fund that will suggest and control the actuarial tables to be used. The choice of such 'tabular standards', purely an exercise of administrative discretion, is properly left to those deemed qualified to make such choice, namely, the board of trustees with the aid of their technical adviser, the actuary.") (regarding decision of state retirement board concerning which actuarial tables to employ pursuant to enabling statute requiring actuarial reference); see also White v. Public Employees Retirement Bd., Docket Nos. CC040404118, 041111848; CA A142773, SC SO59213, Slip Op. at *7 (Or. Dec. 30, 2011) ("PERB must comply with statutes that that require specific allocations or payments to beneficiaries and to various reserve and other accounts. As to actions that are not mandated or prohibited by statute, we agree with the parties that [the Public Employees Retirement Board] has discretion in administering the

[retirement] fund").³ The LGC properly relied upon its discretion to use surplus funds to limit otherwise substantial rate increases to a level far below what the participating municipalities would find in the private market, Exhibit C at, *e.g.*, 75, 81-82, 99-100. The LGC's choice is consistent with, and plainly not prohibited by, RSA 5-B.

Because Mr. Andrews and the other Respondents have, at all times, acted in compliance with, and not in violation of, RSA 5-B, Count 2 should be dismissed.

- II. The Bureau cannot impose liability for non-compliance with standards that are not expressed in RSA 5-B:5, were not contemplated by the legislature, and were composed ad hoc by the Bureau.
 - a. The Bureau has no power to impose substantive requirements beyond those contemplated by RSA 5-B:5.
 - i. Agency authority is limited to that specified by the statute, and regulations that exceed that authority are invalid.

It is axiomatic that an agency may not act beyond the authority given it by the legislature. *Ferretti v. Jackson*, 88 N.H. 296, 305 (1936). Although an agency may enact rules and regulations to "fill in details" to effectuate the purpose of the statute, if a rule exceeds the limited discretion expressly granted by a valid enactment, the rule is invalid. *See Kimball v. New Hampshire Bd. of Accountancy*, 118 N.H. 567, 568-569 (1978) (quotations and citations omitted); *Milette v. New Hampshire Retirement System*, 141 N.H. 342, 347 (1996); *State v. Normand*, 76 N.H. 541, 543-44 (1913).

Here, the legislature has refrained from setting standards for the amount of reserves, administrative costs, or costs to pay claims and excess insurance that would be appropriate for pooled risk management programs. *See* RSA 5-B:5, I; 2010 N.H. Laws 149 *et seq*. (ordering a report on appropriate reserve and administrative costs, but

³ In *White*, two active members and one retired member of the Oregon Public Employees Retirement System alleged that certain acts of the Oregon Public Employees Retirement Board violated the Board's "common-law fiduciary duties and its 'statutory fiduciary duties and obligations" to its members. *Id.* at 3.

foregoing an amendment to the statute to set standards regarding these issues). The legislature also has declined to direct the manner in which any surplus arising after these costs are assured should be returned to the participating municipalities. *Id*.

In alleging the charges against Mr. Andrews and others, the Bureau seeks to impose its own determinations about the amount of reserves and administrative costs that are appropriate for a pooled risk program. This is not an action the legislature neglected. Instead, it *affirmatively* declined to enact such regulation. *See*, generally, 2010 N.H. Laws 149. By substituting its judgment for that of the choice made by the General Court, the Bureau has substantially exceeded its regulatory authority under RSA 5-B, and therefore its standards and all claims of violations of them, are invalid. *Kimball*, 118 N.H. at 568 ("Rules adopted by State boards and agencies may not add to, detract from, or in any way modify statutory law... If a board, in making a rule, acts beyond the limited discretion granted by a valid enactment, the rule is invalid.") (internal quotations and citations omitted).

ii. Ad hoc standards are without effect.

In addition to overstepping its statutory and regulatory authority by applying standards that were not enacted or directed by the legislature, the Bureau created these standards *ad hoc*. Even if the Bureau had authority to enact the standards with which it now seeks to impose liability on Mr. Andrews and others, the standards would be invalid because they were created arbitrarily; that is, with no rule making process or publication that would put the LGC, Mr. Andrews or any other similarly situated entity or individual on notice of such standards. *Appeal of Nolan*, 134 N.H. 723, 728 (1991) ("[A]n agency may not undertake *ad hoc* rule-making: An unwritten, verbally promulgated regulation

that was put into effect at some unknown time ... is *without effect* because there was no indication that the unwritten regulation on which the agency relies met any of the basic requirements of our Administrative Procedures Act") (quoting *Appeal of John Denman*, 120 N.H. 568, 573 (1980) (internal quotations) (emphasis added)).

Because the Bureau seeks to hold Mr. Andrews and others liable for breaching standards of which they had no knowledge or notice, and instead, were arbitrarily created in the context of the Staff Petition, Count 2 must be dismissed.

iii. If interpreted as alleged by the Bureau in Count 2, RSA 5-B:4-a, II violates Part I, Article of the New Hampshire Constitution because it impermissibly delegates legislative authority to the Secretary of State.

The Bureau's anticipated reliance upon RSA 5-B:4-a, II as authority to set standards it claims have been violated is misplaced.⁴ RSA 5-B:4-a, II states: "The secretary of state shall have all powers specifically granted or reasonably implied in order to perform the substantive responsibilities imposed by this chapter." While this paragraph and section give the Bureau the authority to conduct investigations into possible violations of the Chapter, it does not imply the authority to determine what constitutes a violation above and beyond the requirements stated in RSA 5-B:5. Rather, if RSA 5-B:4-a, II allowed the Bureau to assume such substantive determinations, it would represent an unconstitutional delegation of legislative authority to the executive branch in violation of part I, Article 37 of the New Hampshire Constitution. *See New Hampshire Dept. of Environmental Services v. Marino*, 155 N.H. 709, 715 (2007); *Kimball*, 118 N.H. at 569 ("It is the responsibility of th[e] court to insure that another will

⁴ RSA 5-B:4-a became effective on June 14, 2010. Although not raised in the instant pleading, the Bureau's attempted unconstitutional retrospective application of RSA 5-B:4-a to conduct that occurred prior to the effective date of the statute will be the subject of a separate motion.

is not substituted for that of the legislature when, out of necessity, it delegates certain limited powers.").

The New Hampshire Supreme Court has described the test for an impermissible delegation of legislative authority as follows:

Under the separation of powers article of the New Hampshire Constitution, the General Court may not create and delegate duties to an administrative agency if its commands are in such broad terms as to leave the agency with unguided and unrestricted discretion in the assigned fields of its activity. Thus, we have ruled unconstitutional statutes that are devoid of either a declared policy or a prescribed standard laid down by the legislature. To avoid the charge of unlawfully delegated legislative power, [a] statute must lay down basic standards and reasonably define policy for the administration of law.

Marino, 155 N.H. at 715 (internal citations and quotations omitted). As the Court wrote in *Ferretti*:

[A] general standard to uproot harmful conduct and to advance welfare, without further declaration in specification or in prescription of action, is too broad. Delegation of power to enact laws implemental to enforcement of a general law does not constitutionally include delegation of power to pass in full freedom of discretion upon both the expediency and the manner of the invocation of regulatory control.

88 N.H. at 302.

As explained in the first section of this motion, RSA 5-B includes standards, and the LGC complied with the standards enacted by the legislature. The Bureau's desire to interpret RSA 5-B to contain or afford it the authority to establish additional requirements is constitutionally impermissible because the statute is "devoid of either [such] a declared policy or a prescribed standard laid down by the legislature." *See Marino*, 155 N.H. at 715. Moreover, "a legislative enactment that gives [an agency] greater discretion than that needed to 'fill in details' is invalid." *Kimball*, 118 N.H. at 568.

Without any guidelines from the legislature - guidelines the legislative history conclusively shows the General Court refrained from establishing - a statute that confers substantial enforcement powers on the Secretary of State for violations of this kind "authorizes or even encourages arbitrary and discriminatory enforcement." *Marino*, 155 N.H. at 716; *see Kolender v. Lawson*, 461 U.S. 352, 358 (1983) ("When the Legislature fails to provide ... minimal guidelines a ... statute may permit a standardless sweep that allows policemen, prosecutors and juries to pursue their personal predilections.") (internal quotations and brackets omitted). Accordingly, the Bureau lacks the power to define and impose the standards in RSA 5-B for which it seeks to assess liability against Mr. Andrews and others. Count 2 should be dismissed.

b. The imposition of liability for Count 2 as urged by the Bureau would violate Mr. Andrews' due process protection pursuant to part 1, article 15 of the New Hampshire Constitution and the Fifth Amendment of the United States Constitution because RSA 5-B is vague and indefinite.

As stated above, the standards that the Bureau claims have been violated cannot be found in RSA 5-B. Assessing liability against Mr. Andrews for failure to adhere to these unarticulated standards would violate his right to due process pursuant to part I, article 15 of the New Hampshire Constitution and the Fifth Amendment to the United States Constitution because RSA 5-B is vague and indefinite regarding the Bureau's alleged standards. *See Opinion of the Justices*, 128 N.H. 1, 12 (1986) (requested amendment to business profits tax unconstitutionally vague and indefinite because term "foreign" in "foreign dividends" undefined). Moreover, the imposition of liability would represent an affront to the principle "that no person should be held ... responsible for conduct which he or she could not reasonably understand to be proscribed." *State v*.

Lamarche, 157 N.H. 337, 340-41 (2008) (interpreting criminal law) (quoting *Palmer v. City of Euclid*, 402 U.S. 544, 546 (1971)).

"Vagueness may invalidate a statute either because it fails to provide people of ordinary intelligence a reasonable opportunity to understand what conduct it prohibits, or because it authorizes and even encourages arbitrary and discriminatory enforcement."

Marino, 155 N.H. at 716 (internal quotations and citations omitted). When reviewing a vagueness challenge to the application of a statute, an adjudicative authority "examine[s] whether the statute provided the respondents with a reasonable opportunity to know that their particular conduct is prohibited." Id.

While RSA 5-B:5 requires the LGC to return surplus funds to participating municipalities after assuring that it has reserves, and funds to pay claims, excess insurance, and administrative costs, the statute does not establish a specific limit on the size of reserves or the amount a pooled risk program can spend on administration.

Importantly, the LGC complied with the statute's requirement in seeking an accredited actuary to provide a methodology for determining an appropriate reserve level for its pooled funds. RSA 5-B:5 does not prohibit the actuarial methodology employed, or the reserve limit set, by the LGC. The statute also does not impose a limitation with respect to administrative costs or require the return of surplus funds to participating municipalities in a manner other than rate stabilization. *See* RSA 5-B:5; *see also* Exhibits B-D. Therefore, neither the LGC nor Mr. Andrews could have had an opportunity to understand that a particular level of reserve funds or administrative costs, or a refund that provides rate stabilization, could create liability for them.

As applied in this context, to impose liability on Mr. Andrews and LGC pursuant to RSA 5-B would violate due process because the statute as interpreted by the Bureau is unconstitutionally vague and indefinite. Count 2 should be dismissed.

III. RSA 5-B Does Not Prohibit LGC From Requiring Its Participating Municipalities To Join Ancillary Member-Benefit Organizations.

RSA 5-B:3, I permits municipalities to enter agreements with other political subdivisions for the purpose of obtaining or implementing insurance through pooled risk management. Other than requiring a resolution by a political subdivision's governing body, RSA 5-B:3, I does not set conditions on membership. Thus, RSA 5-B:3 does not prohibit pooled risk programs from conditioning their agreements on additional factors, as the Bureau asserts in Count 2(D). Once again, the Bureau is imposing a prohibition on LGC that is not stated in, and cannot lawfully be implied from, the statute. For the reasons stated above with respect to the imposition of non-existent standards for amounts of reserves, administrative cost restrictions, and the "projected needs of the plan" such *ad hoc*, arbitrary rule making is unconstitutional and invalid. Consequently, Count 2 should be dismissed.

Prayer for Relief

Respondent John Andrews respectfully requests that the Presiding Officer dismiss Count 2 of the Staff Petition in its entirety.

Respectfully submitted,

John Andrews

By and through his attorneys,

February 1, 2012

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was forwarded this day via electronic mail to all counsel of record.

Michael D. Ramsdell, Esq.